A Look At Worker Classification As Calif. Faces $15 Min. Wage

By **Mark Kemple and Anthony Guzman**

Mark Kemple

Anthony Guzman

Recently, the Fight for $15 movement has retaken national prominence.

The U.S. House of Representatives **has introduced a bill** to implement a national $15 per hour minimum wage as part of President Joe Biden's initial legislative push.

And while currently at a national tipping point, for California, the legislative path has already been paved.

In 2016, former Gov. Jerry Brown signed into law Senate Bill 3, which outlined a dual track to the $15 minimum wage.

For companies of 26 or more employees, the state minimum wage will continue to increase year over year until the $15 per hour goal is reached in 2022.

For companies of 25 or fewer employees, the goal is pushed out to 2023. However, California's bill allows for the suspension of this track in circumstances of economic decline — at least a possibility given the COVID-19 pandemic.

Regardless, whatever the mechanism or timeline, a $15 minimum wage is likely a done deal for California.

The $15 per hour minimum wage has complex ramifications — particularly for California employers with employees at or near the current earnings threshold to qualify for exemptions from overtime laws.

Certain salaried and commissioned exemptions require the worker to earn a specified multiple of the minimum wage — i.e., 2 times or 1.5 times, respectively — across an annualized period.

Consequently, increasing the minimum wage increases the salary threshold to qualify for the exemption.

If exempt employee salaries fall under the new threshold in the process, employers may be forced to either pay those employees more, reclassify that — potentially significant — portion of their exempt workforce, or face significant damages and penalties under the Labor Code. With this, the issue takes on increased significance.

What California Overtime Exemptions Are Affected?

California's Labor Code and wage orders provide that certain employees are exempt from overtime obligations altogether, often due to a variety of factors ranging from their profession, job duties or compensation structure.

Two main categories of exemptions, however, are directly affected by minimum wage increases: (a) the administrative, executive and professional exemptions; and (b) the inside

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sales exemption.

For the administrative, executive and professional exemptions, the test is similar.

Apart from a few nuances, each exemption generally requires the employee: (a) perform exempt tasks more than 50% of the time; and (b) earn at least 2 times the state minimum wage for full-time work — i.e., 40 hours per week.

In turn, the test for the inside sales exemption requires the employee: (a) earn more than 50% of their compensation from commissions; and (b) earn at least 1.5 times the state minimum wage.

How Are They Affected?

Each of these exemption tests evaluates compensation as a multiple of the jurisdiction's minimum wage generally based on 2,080 annualized hours — i.e. 40 hours per week times 52 weeks per year.

As a result, employees can often automatically lose their exempt status if the minimum wage increases and the employer fails to concurrently increase their compensation.

For example, as of Jan. 1, an employee at a company of 25 or fewer employees making exactly 2 times minimum wage, or $54,080 per year — i.e. $13 per hour times 2 times 2,080 hours per year — would qualify for the traditional administrative, executive and professional exemptions, so long as the other requirements were satisfied.

When the minimum wage increases to $15 per hour though, the minimum salary requirement suddenly leaps to $62,400 per year — a more than 13% jump.

Thus, minimum wage increases often force employers to engage in a cost-benefit analysis of whether to raise an employee's compensation to reach the exemption's newly adjusted salary threshold or reclassify the employee as nonexempt.

If the cost of the employee's raise is greater than the projected cost of the hourly and overtime wages that would be due as a result of the loss of the exemption, then reclassification may make sense.

Conversely, raising the employee's salary to reach the newly adjusted exemption salary threshold may be the better course of action.

Depending on the exemption, employers may also need to look at other cost considerations in determining whether to preserve the exemption.

This is because some exemptions relieve employers from more than just overtime requirements. For example, unlike the inside sales exemption, and the administrative, executive and professional exemptions also exempt employers from other obligations as well, such as the obligation to provide meal or rest periods, and even to maintain certain timekeeping records.

In practice, these additional obligations come with associated costs. Thus, the increased compensation to the worker that may be required to maintain an exemption may be offset by avoiding other obligations that accompany reclassification.

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Intangible considerations also exist, as workers often view loss of exempt status and conversion to hourly pay as a demotion in status.

Moving Forward

Whether by state or federal mechanism, and irrespective of the exact timeline, a $15 minimum wage is likely coming to California.

As a result, employers may want to take the following tips when analyzing the potential effect of minimum wage increases in their workplaces.

First, employers should audit their exempt workers and positions, using (a) the correct minimum wage depending on the year and company size and (b) the correct minimum wage multiplier — i.e. 2 times or 1.5 times — depending on the specific exemption at play, to determine whether the worker will lose exempt status when the minimum wage increases.

Second, employers should analyze the cost/benefit of increasing wages to formerly exempt workers whose current compensation would not qualify for exemption after an increase in the minimum wage.

To do so, employers should consider the relative costs of increasing employee salaries, the costs of projected hourly wages and overtime premiums if an exemption is lost, and whether the loss of the particular exemption also affects other employer obligations or the employee's morale.

Third, effectively communicate any change in exemption status. In doing this, however, employers may need to explain why the decision was made, how it is likely to affect the employee's compensation, timekeeping obligations and break opportunities.

Reassuring the employee of their continued importance to, and authority within, the organization may also be helpful.

Finally, consider whether to monitor working hours. If raising employee salaries to keep an exemption is the best choice, employer's may still want to keep an eye on the hours worked by these employees.

Arguably, the salary thresholds are all predicated on the underlying assumption that an employee is only working 40 hours per week — i.e., 2,080 per year.

If an exempt employee regularly earns more than that, an employer must consider the hours actually worked to ensure that the salary covers 2 times or 1.5 times the minimum wage — potentially leading to an inadvertent and hard to detect loss of the exemption.

Each workplace is unique. Reclassifications that makes sense for some employers may not make sense for others. As a result, employers should independently analyze the pros and cons of reclassification according to their strategic goals and their employee's needs.

Mark D. Kemple is a shareholder and Anthony E. Guzman is an associate at Greenberg Traurig LLP.

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